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DEPARTMENT FOR EUR/SCE, EUR/ERA, TREASURY FOR INTERNATIONAL
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TAGS: ECON EFIN PGOV HR
SUBJECT: NEW BUDGET TOPS GOC'S SET OF ANTI-RECESSION
MEASURES

¶1. Summary: On February 26, PM Sanader announced a set of ten anti-recession measures the government will pursue. The first measure will be to cut budget expenditures by HRK 1-3 billion ($175-526 million). Other measures will increase support for exporters, small and medium size enterprises (SMEs), tourism, and agriculture. To promote foreign investment, the government aims to improve coordination among agencies and local governments and speed up licensing processes. Given the fiscal and monetary constraints, the proposed measures seem generally sound, although without better control of costs and expenditures, the other measures announced may prove to be cosmetic. End summary.

¶2. On February 26, PM Sanader announced a set of ten anti-recession measures the government will pursue. On March 2, the ambassador attended a meeting held by Minister of Finance Ivan Suker, along with state secretaries from the Ministries of Economy and Foreign Affairs, to discuss the measures with ambassadors from NATO and EU countries. Suker began his presentation with a summary of the impacts of the economic crisis on Croatia thus far. He said Croatia survived the first blow of the crisis but nonetheless has seen a slowdown in most economic activity indicators. He noted the pronounced effects on the real economy, including a deceleration of domestic consumption, investments, imports and exports.

¶3. As the first step in basic budget reform, the prime minister has asked all ministers to submit cost-cutting plans by the middle of next week. Suker said they are working to rebalance the budget and plan to finish the revision by the end of March. Some opposition leaders have called for an expenditure reduction of HRK 12 billion ($2.1 billion) or more to ensure a zero deficit. In response, PM Sanader said in a March 2 radio interview that the budget cuts will amount to HRK 1-3 billion ($175-526 million), noting that the budget revision is just one of a set of measures to counter the recession.

¶4. To ease costs for the private sector, certain state institutions, such as the Chamber of Economy, will reduce the mandatory fees they charge. The state will also seek to improve cash flow and payment of financial obligations of public enterprises, and thus assist the private sector. To increase support for exporters, small and medium size enterprises (SMEs), tourism, and agriculture, the GOC will secure additional funding for the Croatian Bank for Reconstruction and Development (HBOR). Regarding the critical tourism sector, Suker told the ambassadors that bookings for 2009 look good so far, but all the same, the Ministry of Tourism will develop a new action plan to increase promotion and competitiveness in the sector. Measures aimed at helping individuals include subsidizing interest on loans for first-time property buyers, prevailing on banks to lower interest rates, and securing funds to support socially

vulnerable groups.

¶5. To create more favorable conditions for foreign direct investment (FDI), the government would introduce an "express line" for issuing all licenses within 45 days for FDIs above EUR 10 million, though Suker added that this would apply only to investments already included in local district plans. Suker also commented on another of the measures: strengthening control over imports. Assuring the ambassadors that this would not amount to protectionism, he said the GOC will only seek to better enforce existing laws, such as those for quality control and safety.

¶6. The largest trade unions and the Croatian Employers Association (HUP) reacted mostly positively to the announcement of the measures. Union representatives told the press the measures could be more comprehensive, particularly those intended to maintain living standards. HUP's general director told the press he welcomed the government's awareness that it had to take action and that all players in the economy must be involved. He commented, however, that the measures were really a set of general messages requiring further elaboration and immediate implementation. Representatives of the opposition Social Democratic Party (SDP) and Croatian People's Party (HNS) were more critical. They told the press adoption of the measures was four months overdue. One representative expressed skepticism Minister Suker would be able to find HRK 3 billion to cut from the budget, while others said the proposed cuts were too small and called for cuts of HRK 7-12 billion ($1.2-2.1 billion) instead.

¶7. Comment: Except for the efforts to bring down costs in

the ministries, many of the measures announced seem cosmetic. It is not apparent whether they will actually promote financial stability. For example, although important, it remains unclear how reducing fees companies pay to business promotion agencies or reducing payment times from state industries will address the big picture challenges of costs and revenues faced by the private sector. The key measure - reducing expenditures - will face important hurdles as well. Despite significant political effort, the government could not balance the budget several months ago when Croatia's 2009 GDP growth projection was a now seemingly lofty two percent. But the government must achieve a more realistic budget. To paraphrase a prominent local economist, if the government does not take action to promote financial stability, then Croatia will have to bring in the IMF, which will implement what the government failed to achieve: fiscal consolidation.
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